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SENSITIVE
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STATE FOR EB/IFD/OMA
TREASURY FOR DO/IDD AND OUSED/IMF
SECDEF FOR USDP/DSAA
PASS EXIM FOR CLAIMS -- EDELARIVA
PASS USDA FOR CCC -- ALEUNG/DERICKSON/KCHADWICK
PASS USAID FOR CLAIMS
PASS DOD FOR DSCS -- PBERG

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SUMMARY
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¶1. (SBU) At the May 22-24 meeting of the Paris Club, creditors agreed to allow Peru to prepay at face value as much as $2.5 billion in previously rescheduled non-concessional debt in order to support its efforts to implement sound debt management policies. The Secretariat reported on technical talks with Argentina, which asked

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for concessions on late interest and access to new export credits in exchange for clearing its arrears. Paris Club creditors agreed that continued technical talks should be encouraged, but were reluctant to consider any concessions until Argentina makes a serious offer. Creditors also discussed how to proceed in normalizing financial relations with Angola, which has almost fully cleared its arrears to the Paris Club, but continues to owe late interest. In recognition of its progress on economic reform and reaching the "Completion Point" of the Heavily Indebted Poor Country (HIPC) initiative, Paris Club creditors granted Sao Tome and Principe the final phase of HIPC debt relief. Turning to a debt issue currently drawing press and political attention in several countries, the Paris Club discussed what, if any, actions creditors should take to counter threats to HIPC debt relief posed by litigating creditors. During its 7th

annual session with the private sector, the Paris Club exchanged views on best practices for advancing our debt treatment objectives for low-income countries (LICs). The Paris Club also reviewed progress on debt issues for the Comoros (pre-HIPC eligibility), Iraq (progress on various bilateral debt deals), Serbia and Montenegro (division of former Yugoslavia debt), and Zimbabwe (legal action to collect debt).

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Angola
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¶2. (SBU) The Netherlands and Sweden reported that Angola still had not cleared all arrears. In light of ongoing dialogue with Angola, however, both countries said they believed the continued delays reflected weak debt management capacity rather than an unwillingness to pay. The Paris Club Secretariat said Angolan Finance Minister de Morais had promised to continue working with the Club to clear these remaining arrears (excluding late interest). The United States informed the Club it had refunded a $3 million overpayment to Angola. Japan, the Netherlands, and Norway said their export credit agencies (ECAs) were under increasing pressure to reopen in Angola, but remained off-cover for now to maintain Paris Club solidarity. Spain confirmed that its ECA was open for short-term financing, but said Angola thus far has been interested only in medium- and long-term financing.

¶3. (SBU) Japan requested that, once all arrears are cleared, the Club proceed swiftly to implement its previously agreed plan of action. (According to this plan, set out by the PC Chair in March, once arrears are cleared, Angola should unilaterally pay 40-60% of late interest due, and then propose a schedule for paying off the balance over time. In return, Paris Club members' ECAs, at their discretion, could decide to go on-cover. As an additional



inducement, creditors might offer, on a bilateral basis but subject to Paris Club coordination, to reduce the late interest rate or any penalty charges. Creditors could also offer debt-for-aid and debt-for-equity swaps, based on existing limitations.) The United States cautioned that offering concessions on late interest could be interpreted as rescheduling without an IMF agreement, and also have a spillover effect on Argentina. The Secretariat countered that Angola and Argentina were different cases.

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Argentina
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¶4. (SBU) Summarizing recent technical discussions with Argentine Finance Secretary Chodos, the Secretariat reported having underscored and explained the reason for requiring an IMF program as a condition of a Paris Club rescheduling. As an alternative, Argentina could propose a unilateral plan for clearing its arrears. Chodos asked if Paris Club creditors, in return, would be willing to stop the clock on late interest and begin offering ECA financing before arrears were completely cleared. Creditors were generally united in their reaction, agreeing that technical discussions should continue, but remaining reluctant to consider any concessions until Argentina makes a concrete proposal, possibly including initial unilateral payments on arrears.

¶5. (SBU) The Secretariat encouraged creditors to start thinking about what sort of arrears payment plan they would find acceptable and what flexibility their ECAs might have after Argentina made the first move. The United States said it had no flexibility on late interest or ECA cover policy (i.e., arrears must be fully cleared), and urged creditors to stand firm. Japan and Italy, citing the alternative scenarios included in the GOA's recent non-paper, stressed that Argentina was capable of clearing its arrears. (The IMF reported that Argentina continues to accumulate reserves but believes the government has no plans to alter its unsustainable economic policy mix.) Japan said waiving interest was tantamount to a rescheduling and therefore was a non-starter. The Secretariat noted that there appeared to be no enthusiasm among creditors to stop the clock on late interest.

¶6. (SBU) During an earlier G7 debt-experts discussion, Germany indicated its ECA was not under pressure to reopen and said any decision to go back on cover before arrears were fully cleared would be a political one. Several participants questioned whether Argentina was indeed serious about arranging to clear its Paris Club arrears before national elections in October. France thought this pre-election period might be a window of opportunity for the Paris Club, but cautioned that taking advantage of it would not be cost-free. France underscored the need to adhere to Paris Club principles in trying to find a way forward on Argentina, but also suggested that once Argentina starts to clear its arrears, ECAs could reopen export cover at their discretion.

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Comoros
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¶7. (U) The IMF reported its Board's discussion of Comoros' Poverty Reduction and Growth Facility (PRGF) request had been postponed pending financing assurances from the African Development Bank (AfDB). Because Comoros is $31 million in arrears, the AfDB must reclassify it as a post-conflict country to give it access to an arrears clearance facility. The IMF said this will not happen until end-June. Given this delay, the Secretariat will hold off inviting Comoros to negotiate the terms of a Naples flow treatment.

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Iraq
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¶8. (SBU) The Secretariat announced the "good news" that Saudi Arabia had agreed to provide Iraq debt relief on Paris Club comparable terms. Responding to an Iraqi letter to the Secretariat asserting that Russia was attempting to tie debt relief to oil contracts (a breach of Paris Club principles), the Russian delegation said it understood Club concerns, which its Finance Minister had shared with the government, but had no official reaction at this time. Italy urged Russia not to wait another month to respond to such a serious allegation.

¶9. (SBU) Referring to another Iraqi letter asking for assistance in sorting out a contested post-1990 claim by Germany, the Secretariat requested that discussions be postponed until next month given the complexity of the case. Germany asserts the $68 million claim involves a transfer of funds stranded in the Iraqi central bank that should be excluded from the Paris Club debt treatment. Documentation provided by Iraq indicates this is a complicated, unsettled transaction covered by the PC deal, rather than a simple transfer case. In an exchange on the margins of the meeting, Germany told us that, under the terms of the contract, it is seeking arbitration with Iraq to determine whether the claim should be treated under the PC Agreed Minute.

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Peru
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¶10. (U) Creditors concluded an agreement that will allow Peru to prepay at face value the entirety of its previously rescheduled non-concessional debt falling due between 2007 and 2015. Peru was confident that it could raise enough money in the market to finance prepayment of all eligible debt, and did not request a withdrawal clause in the agreement as it had done for a similar prepayment operation last year. All creditors except France and Italy announced their intention to allow all of their eligible claims to be prepaid. Italy said it would offer a portion (yet to be decided) of its claims, while France said it was still undecided (a decision for its new Finance Minister). Both France and Italy said high fixed interest rate contracts meant prepayment at face value entailed a large budgetary cost, but joined other PC creditors in voicing support for Peru's proposal as sound debt management policy. Total Paris Club debt to be prepaid could amount to as much as $2.5 billion, of which $450 million is owed to the US.

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Sao Tome and Principe
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¶11. (U) STP's Completion Point agreement under the Heavily Indebted Poor Country (HIPC) initiative paves the way for 100% cancellation of its Paris Club debt. Belgium, France, Germany, Spain, and Russia agreed to cancel $23.9 million in nominal terms, representing their share of HIPC debt relief. The remaining $0.6 million in official development assistance (ODA) claims will be canceled on a voluntary basis. (The United States is not a creditor.)

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Serbia and Montenegro
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¶12. (U) Citing the recent installation of a new government, creditors agreed to give the Serbian authorities another month to respond to the letter, sent by the Secretariat on behalf of Germany, Japan, the Netherlands, Sweden, and Switzerland, reiterating that Serbia and Montenegro must sign new bilateral agreements with Paris Club creditors based on the debtor/guarantor principle, unless the creditor agrees otherwise. In the meantime, the Secretariat will draft a letter to the newly appointed Finance Minister explaining the current situation.

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Zimbabwe
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¶13. (SBU) The United States reported that its export credit agency (Exim Bank) was using legal recourse (consistent with the Paris Club's July 2005 letter to Zimbabwe) to preserve its rights that were set to expire under the six-year U.S. statute of limitations. Faced with threat of a suit in early May, Zimbabwe paid the US a $5 million arrears installment. The United States intended to pursue the claim in court in July if Zimbabwe did not pay off the entire remaining $40 million debt. The Netherlands revealed that it had taken similar action in 2005-2006 and was able to recover EUR 5 million. The UK reported it had recently gone to court to extend the statute of limitation on its claims. (Note: Since this meeting, the government of Zimbabwe made an additional $40 million payment to settle the bulk of its debt to ExIm. Zimbabwe still has debt in arrears to other USG agencies.)

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Selling Claims and Litigating Creditors
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¶14. (SBU) The Paris Club issued a press release stating that creditors "are committed to avoid selling their claims on HIPC countries to other creditors who do not intend to provide debt relief under the HIPC initiative, and urge other creditors to follow suit." The press release was the result of a protracted and at times acrimonious debate in the Club. The Secretariat was intent on highlighting the "threat" posed by litigating creditors to HIPC



countries and received strong support from Denmark, the Netherlands, and the UK, all of whom stressed that the Paris Club needed to react to this increasingly important domestic political issue. Offering what seemed to be a lone dissenting voice, the United States argued that an emphasis on litigation was misplaced, and that the press release should instead call on all non-Paris Club creditors to provide comparable treatment under the HIPC initiative.

¶15. (SBU) The press release also stated that "creditors have agreed to intensify their work on this issue with a view to identify concrete measures to tackle the problem," reflecting a strong desire by most Club members to act. There was limited debate on what measures might be taken or could be effective, but the Netherlands

captured the general mood in noting that there was political momentum the Club should use. At the same time, some creditors acknowledged that the issue of litigating creditors was a complex one, the Club's tools were limited, and litigation and trading debt on secondary markets were important tools of a well functioning international financial system.

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Annual Meeting with the Private Sector
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¶16. (U) Private sector HIPC restructuring: This was the first of three themes discussed as part of the Paris Club's 7th annual meeting with the private sector. A BNP Paribas representative made the case that, contrary to popular perception, commercial creditors were committed to providing debt relief under the HIPC initiative. He blamed delays on the failure of debtor countries to initiate a dialogue with creditor committees. The World Bank and a Lazard representative gave presentations on the merits of the Bank's Debt Reduction Facility (DRF). The Bank has extended the DRF to 2012 in order to help resolve commercial debt, which represents a large share of the total debt burden for several HIPC cases. Both parties characterized the decision in 2004 to restrict the DRF to countries having reached Decision Point as a key improvement.

¶17. (U) Responding to a concerned raised about the negative impact of litigation on resolving HIPC debt, a Greylock Capital representative argued convincingly that litigation plays a useful and legitimate role in financial markets. He claimed that so-called "vulture funds," which he defined as those whose business model is to extract large gains through litigation, were in fact a very small subset of all creditors. For the vast majority, litigation was a last resort when debtors failed to enter into good-faith negotiations. Another private sector representative added that, in the wake of Argentina's default, those who were previously reluctant to litigate had been forced to reevaluate their strategy.

¶18. (U) New lending and debt sustainability in low-income countries (LICs): On this second topic, the IMF provided an overview of the joint Bank-Fund Debt Sustainability Framework (DSF) for LICs, a tool designed to identify debt-related vulnerabilities. Using a 20-year baseline scenario, the DSF looks at the impact of shocks on debt sustainability, evaluates institutional and policy capacity to manage debt, sets debt level and policy benchmarks, and recommends



borrowing strategies for LICs. A representative from Fitch Ratings discussed debt sustainability in Sub-Sahara African countries, explaining the limited impact debt relief has on its country ratings in the absence of substantial policy changes.

¶19. (U) Update on debt restructurings in the private sector and in the Paris Club: A representative from Houlihan Lokey reviewed Belize's recent debt restructuring experience in which private sector collective action played a critical role in negotiating a deal that extended maturities and put Belize on a sustainable debt path. The Institute for International Finance applauded Belize (and separately the Dominican Republic) for following the IIF's "Principles" as a guide for working with creditors in an open, transparent, and fair manner. Representatives from Greylock Capital and the Global Committee of Argentina Bondholders presented the contrary case of Argentina. They highlighted its strong economic recovery and warned against the negative impact on financial markets of allowing Argentina's unilateral debt restructuring to stand as a precedent.

STAPLETON